Supreme Court, U.S.
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No. 78-677

In the Supreme Court of the United States

OCTOBER TERM, 1978

ARTHUR YOUNG & COMPANY, PETITIONER

v.

SECURITIES AND EXCHANGE COMMISSION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION IN OPPOSITION

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OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-35a) is not yet reported. The opinion of the district court (A. 100-103)[1] is unreported.

[1] "A." refers to the joint appendix filed in the court of appeals.

JURISDICTION

The judgment of the court of appeals was entered on July 24, 1978.[2] The petition for a writ of certiorari was filed on October 21, 1978. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether the Securities and Exchange Commission, after obtaining information that the financial statements of a publicly-held company contain material misrepresentations and omissions regarding substantial misuse of the company's assets, may subpoena documents relevant to the accuracy of those financial statements and the adequacy of the audits performed on them.

STATUTES INVOLVED

Section 19(b) of the Securities Act of 1933, 15 U.S.C. 77s(b), is reproduced at Pet. 3. Sections 21(a) and (b) of the Securities Exchange Act of 1934, 15 U.S.C. 78u(a) and (b), provide, in part:

> (a) The Commission may, in its discretion, make such investigations as it deems necessary to determine whether any person has violated, is violating, or is about to violate any provision of this chapter, the rules or regulations thereunder * * * and may require or permit any person to file with it a statement in writing, under oath or

[2] On September 14, 1978, the court of appeals modified its opinion in certain respects not relevant to the issues raised in the petition. See Pet. App. 34a-35a.

> otherwise as the Commission shall determine, as to all the facts and circumstances concerning the matter to be investigated. The Commission is authorized in its discretion, to publish information concerning any such violations, and to investigate any facts, conditions, practices, or matters which it may deem necessary or proper to aid in the enforcement of such provisions, in the prescribing of rules and regulations under this chapter, or in securing information to serve as a basis for recommending further legislation concerning the matters to which this chapter relates.
>
> (b) For the purpose of any such investigation, or any other proceeding under this chapter, any member of the Commission or any officer designated by it is empowered to administer oaths and affirmations, subpena witnesses, compel their attendance, take evidence, and require the production of any books, papers, correspondence, memoranda, or other records which the Commission deems relevant or material to the inquiry. Such attendance of witnesses and the production of any such records may be required from any place in the United States or any State at any designated place of hearing.

STATEMENT

Following a staff report on the results of a preliminary investigation, the Commission ordered a formal investigation to determine whether SCA Services, Inc. ("SCA") and others violated the antifraud provisions of the federal securities laws (Pet. App. 1b-3b). The Commission had received information from its staff indicating that certain SCA registration

statements, prospectuses, proxy statements and periodic reports contained material omissions and misrepresentations. The Commission's investigation concerned SCA's disclosures relating to the interest of SCA's management and other persons in SCA's financial transactions, SCA's descriptions of its business and property, and SCA's acquisition and disposition of assets. It also concerned the integrity of SCA's financial statements (Pet. App. 2b). The Commission's order designated certain staff members to conduct the investigation and authorized them to subpoena documents relevant to the inquiry (Pet. App. 3b).

One of the designated staff members issued a subpoena duces tecum to petitioner, SCA's independent auditor. The subpoena, which set forth 14 categories of requested materials, called for the production of audit work papers and related documents pertaining to petitioner's audits of SCA's financial statements, as well as materials pertaining to special engagements and management consulting services performed by petitioner for SCA. In addition, the subpoena requested similar materials, to the extent they existed, regarding SCA affiliates and subsidiaries and certain designated persons believed to be related to SCA and its associates (Pet. App. 1c-3c; A. 57-61).

Petitioner refused to comply with the subpoena, and the Commission sought enforcement in the district court. The Commission advised the district court that although its staff's inquiry originally focused on disclosures relating to possible management self-dealing and looting, the inquiry had broadened to

include the integrity of SCA's financial statements and the adequacy of petitioner's audits of those statements (A. 16-20, 45-46). The Commission filed an affidavit of a staff accountant explaining that it was "necessary to this investigation into the integrity of the financial statements of SCA and other aspects of its filings with the Commission for the Commission staff to make a comprehensive review of audit workpapers * * *" (A. 18).[3]

The district court found that the Commission's investigation was authorized by law and that the documents sought in the subpoena were relevant to the investigation (A. 100-101). In order to ease the burden of compliance with the subpoena, however, the district court directed the Commission to examine the requested documents at the offices where they were kept, and to bear the expense of copying all documents except those that petitioner would not relinquish for copying (A. 102-103).

The court of appeals affirmed, pointing out that Congress vested the Commission with broad investi-

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[3] The accountant's affidavit stated further (A. 18):

> Documents that [petitioner] has relating to SCA * * * are * * * necessary to determine the adequacy of SCA's disclosure of interests of management in certain transactions * * *. Such transactions may also be disguised and treated in financial statements as bona fide transactions occurring in the ordinary course of business. The subpoenaed materials are necessary to obtain evidence and leads as to possible violations by SCA's management, determine whether the audit procedures followed by [petitioner] were adequate, and whether accounting principles were properly applied.

gative powers, including the power to subpoena relevant documents (Pet. App. 8a). The court found that the Commission's order identified the subject of inquiry with reasonable specificity, and that the subpoena fell within the bounds of that order:

> By our assessment, * * * the particulars of the Commission's investigative order, when coupled with the affidavit's disclosure that the investigation extends to the adequacy of [petitioner's] audits, sufficiently specifies the scope of the investigation and reveals that it is at least as broad as the subpoena's call for documents.

Pet. App. 12a n.48. The court further noted that the areas of inquiry delineated in the Commission's order "are all areas of legitimate concern to the Commission in the discharge of its statutory responsibilities, and categories of data generally required to be submitted to the Commission and disclosed to the investing public" (Pet. App. 11a). The court of appeals also affirmed the district court's finding that the information requested in the subpoena is relevant, noting that the "Commission has established prima facie its potential importance in terms of its investigative objectives" (Pet. App. 21a). Finally, the court rejected the contention that the Commission itself must specify the documents needed to complete the investigation, pointing out that such authority is properly delegated to its staff (Pet. App. 12a-17a).

Sensitive to the expense that could be occasioned by compliance with the subpoena, the court of appeals

modified the district court's order to provide an opportunity for petitioner to show "that the actual expense of compliance with the Commission's subpoena has at any given time become unreasonable and to seek reimbursement accordingly" (Pet. App. 35a; see also *id.* at 26a-32a).

Petitioner complied with the subpoena while the case was pending before the court of appeals.

ARGUMENT

1. Petitioner has complied with the subpoena that it seeks to challenge. In such circumstances controversies about the validity of subpoenas are moot. See, *e.g.*, *Barney* v. *United States*, 568 F.2d 116, 117 (8th Cir. 1978); *Kurshan* v. *Riley*, 484 F.2d 952, 953 (4th Cir. 1973); *United States* v. *Lyons*, 442 F.2d 1144, 1145 (1st Cir. 1971); *United States* v. *Carpenter*, 425 F.2d 264, 265 (5th Cir. 1970); *Baldridge* v. *United States*, 406 F.2d 526, 527 (5th Cir. 1969); *Grathwohl* v. *United States*, 401 F.2d 166, 167 (5th Cir. 1968).[4]

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[4] If, in the future, petitioner deems it necessary to contest the use of any materials that it has produced, it may do so at that time. See *United States* v. *Lyons*, *supra*, 442 F.2d at 1145-1146, quoting *Donaldson* v. *United States*, 400 U.S. 517, 531 (1971): "[i]f and when a future * * * proceeding is initiated * * * 'to the extent that [petitioner] has * * * a protectable interest, as, for example, by way of privilege, or to the extent he may claim [an] abuse of process, [petitioner] may always assert that interest or that claim in due course at its proper place in any subsequent trial.' "

2. In any event, petitioner's arguments are insubstantial. We principally rely on the thorough opinion of the court of appeals, which points out that the subpoena calls only for documents that are relevant to a legitimate Commission investigation. Petitioner repeatedly contends that the subject matter actually under investigation is narrower than the subpoena in question, arguing that the investigation is limited to questions of "looting and self-dealing" (Pet. 20, 23, 10, 11, 17). But petitioner ignores the fact that the Commission's order expressly requires an investigation of SCA's financial statements (Pet. App. 2b) and that the affidavit of the Commission's staff accountant stated that the investigation encompasses an inquiry into "the integrity of * * * [SCA's] financial statements," the adequacy of petitioner's "audit procedures," and the "accounting principles" that were applied (A. 18).

3. Petitioner argues that if the investigation includes SCA's financial statements and petitioner's audits, in addition to disclosures with respect to looting and self-dealing, then the investigative order and subpoena are defective because the Commission lacks authority to conduct such a broad investigation (Pet. 17). But, as the court of appeals explained, this case involves serious questions of the integrity of financial statements included in registration statements, prospectuses, proxy statements and periodic reports filed with the Commission and disseminated to the investing public:

> The investigation focuses on the financial statements and activities of SCA, a publicly-held corporation, and during the period under scrutiny [petitioner] has been the principal independent accountant for that corporation, examining and certifying what the Commission believes to be inaccurate financial statements. The adequacy of the examinations leading to those certifications thus plainly emerges as a logical and permissible subject of inquiry.

Pet. App. 12a. This Court repeatedly has affirmed the breadth of the investigatory powers of federal administrative agencies. See, *e.g.*, *United States* v. *Powell*, 379 U.S. 48, 53-54 (1964); *United States* v. *Morton Salt Co.*, 338 U.S. 632, 642-643, 652 (1950); *Oklahoma Press Publishing Co.* v. *Walling*, 327 U.S. 186, 216 (1946).[5] These decisions confirm the validity of the Commission's subpoena here.

Moreover, this is not a case where an administrative agency is conducting an investigation merely out of "curiosity" or to obtain assurance that the law has not been violated (*United States* v. *Morton Salt Co.*, *supra*). The Commission had information indicating inaccurate disclosures regarding "diversion or other misuse of SCA's assets" (A. 17; Pet. App. 10a). In light of the "preliminary indication of falsifications or misleading omissions in registration statements, proxy materials and periodic reports * * *" (Pet.

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[5] See also *SEC* v. *Howatt*, 525 F.2d 226, 229 (1st Cir. 1975); *SEC* v. *Savage*, 513 F.2d 188, 189 (7th Cir. 1975); *SEC* v. *Brigadoon Scotch Distributing Co.*, 480 F.2d 1047, 1052-1053 (2d Cir. 1973), cert. denied, 415 U.S. 915 (1974).

App. 10a; footnote omitted), it was proper for the Commission to inquire further into SCA's financial statements and audits during the years in question. It was necessary to examine all of the company's financial statements to determine whether episodes of self-dealing were disguised as bona fide business transactions (A. 18). Because of the indication of numerous occurrences of inaccurate reporting, it was appropriate to inquire into SCA's system of financial disclosure as well as the adequacy of petitioner's performance of its audits (Pet. App. 12a, 25a).[6]

4. Petitioner further contends that the decision of the court of appeals upholds an excessively broad subpoena, and that the Commission may now reach "all of the documents in [petitioner's] possession" (Pet. 3, 14). But the subpoena called only for documents relating to SCA and various persons associated with SCA. The materials requested "comprise but one coherent set of work papers and ancillary materials routinely generated and assembled in any

[6] Petitioner also argues that the Commission could not properly delegate to its staff the issuance of a subpoena to obtain relevant documents. But Section 19(b) of the Securities Act of 1933, 15 U.S.C. 77s(b), and Section 21(b) of the Securities Exchange Act of 1934, 15 U.S.C. 78u(b), both provide for such delegation. This Court has recognized that these provisions permit the Commission to delegate its subpoena power. See *Cudahy Packing Co.* v. *Holland*, 315 U.S. 357, 365 n.9 (1942). See also *Woolley* v. *United States*, 97 F.2d 258, 262 (9th Cir.), cert. denied, 305 U.S. 614 (1938), and *Penfield Co. of Cal.* v. *SEC*, 143 F.2d 746, 749-750 (9th Cir.), cert. denied, 323 U.S. 768 (1944), rejecting the contention that the Commission must itself determine what materials are to be subpoenaed.

audit" (Pet. App. 20a). Although the subpoena encompassed many documents, that was a necessary consequence of the complex nature of the Commission's investigation, which involved SCA's financial disclosures as well as petitioner's audits and certifications of SCA's financial statements.

The quantity of material to be produced is not the measure of whether a subpoena is overbroad. The validity of the subpoena is tested by the relevance of the requested material to the subject matter of the investigation. *Adams* v. *FTC*, 296 F.2d 861, 867 (8th Cir. 1961), cert. denied, 369 U.S. 864 (1962); *McGarry* v. *SEC*, 147 F.2d 389, 392 (10th Cir. 1945). Both of the courts below concluded that the materials requested are relevant to the Commission's investigation (Pet. App. 25a; A. 101). There is no reason for this Court to review that factual determination, concurred in by two lower courts.

Moreover, petitioner's arguments about the burdensome nature of the subpoena ignore the protective orders entered by the district court and court of appeals. Those orders required the Commission to examine petitioner's documents at the offices where they were stored and required the Commission to pay for much of the expense of duplication. Petitioner also may apply for cost reimbursement, to the extent that it is appropriate, under the order of the court of appeals (Pet. App. 27a-35a).

5. Finally, petitioner is in error in asserting (Pet. 21-24) that the decision below conflicts with *CAB* v. *United Airlines, Inc.*, 542 F.2d 394 (7th Cir. 1976).

The *United Airlines* case does not involve the issue presented here. In that case the Civil Aeronautics Board argued that it had unlimited visitorial powers and that it was not required either to specify an investigative purpose or to have such a purpose in demanding information. The Seventh Circuit held that nothing in the Federal Aviation Act or its legislative history supported the Board's claim of plenary inspection powers. 542 F.2d at 401. The Commission's order here, in contrast, specifically identifies its investigative purpose, including inquiry into SCA's financial statements, and both courts below held that the subpoenaed documents are relevant to this legitimate investigation.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submited.

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